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## **THE NECESSITY OF CREATING A NEW WORLD CURRENCY**

### **Introduction**

The idea for a world currency system had already begun by the 19<sup>th</sup> century. The proper and efficient functioning for such a system has been determined with its correspondence to the world economy structure and its level of development. The non-compliance of the currency system's components to the world economy's requirements caused the first signs of the recent crisis, which lead in turn to its crash and the emergence of a new system.

All of us have been witnesses to the recent global economic crisis, which at times has been stronger or weaker but has continued until now; and nobody knows how long it may continue. Taking into account the main functions of the world currency system, which consists of international trade relations and the creation of mechanisms for providing an optimum balance between national money relations and the unification and standardization of currency relation principles, the following question arises: Is it possible to overcome this crisis without the creation of a new global currency system?

### **The Current Global Currency System, Its Evolution and Current Issues**

The current global currency system, if one could call it that, was founded on the Bretton Woods system and continues to run under its influence. The Bretton Woods conference's creation of the global currency system structure during its time, contributed to the future globalization of the economy. Apropos, economic globalization has been an impartial and inevitable event; its opponents are similar to the English Luddites who went around during the industrial revolution destroying mechanized looms and fighting for textile worker's rights.

The Bretton Woods currency system, founded in 1944, was a system appropriate for those times providing the further development of global trade and an international division of labor.

The nature of the Bretton Woods system is widely known. The USD functioned as a global currency being once exchanged into gold bullion at a fixed rate of 1 USD = 0.88867 g of gold (1971). The participating countries of the Bretton Woods system then established their currency exchange rates based on the USD, creating the gold exchange standard. The US gold reserve was the material base for this system.

The Bretton Woods system was the peak of the gold standard evolution and the further use of this system could only mean its decline as a standard.

Due to a series of circumstances, the US gold reserves had, by the early 1970<sup>s</sup>, decreased significantly from \$23 bln. in 1957 to \$11 bln. in 1971. The USA had to discontinue the exchange of the USD to gold at its fixed rate (in 1968 – for individual persons, corporations, and commercial banks, and in 1971 – to the central banks of the Bretton Woods participating countries). The gold standard had finally collapsed and the Bretton Woods system became inefficient, but its “infants” still remained alive, which meant the first usage of the USD as a global currency and as a monetary instrument for the IMF.

Using the USD as the new global currency, as the gold standard was ending, meant for the creation of a basic contradiction in international currency relations. The USD could no longer be exchanged for gold at a fixed rate and continued to be the global currency being printed by the Federal Reserve System of the U.S.A. In our opinion, this was the precursor for the current global financial crises started which has continued to develop since then.

It should be noted, that the end of the gold standard had positive and negative consequence. It was also a way to resolve some serious disagreements, though perhaps more painfully. The situation being that during the existence of the gold standard (or any other metal standard), the scope of money creation was determined by the actual availability of the metal and not by economic need.

The disparity between available money reserves and real money needs led to a rise in prices (the “price revolution” in Europe, since the time of Columbus a significant amount of gold had been imported to Europe from the New World).

Figure 1 illustrates the USA’s price dynamics for the last 150 years.

Thus, due to the existence of the USA’s gold standard, prices were stabilized more or less. They increased only during times of war (the Civil War and the First World War). And they returned back to their prewar levels soon afterwards. That is, gold could not have been the only influence on inflation. However the availability of such an instrument had been historically very important. The point is that moderate inflation (several percent per year) allows for the creation of a relatively stable currency while at the same time being a powerful economic stimulus. Since the Second World War, the situation has changed dramatically.

The gold standard had traditionally “tethered” the economy by keeping it in check and limiting its growth. The entire evolution of the gold standard – from the gold coin standard to the gold bullion standard, and continuing on into the gold exchange standard has been this economical tethering (restraint) which has been weakened over time by its own nature.

Thus, the attempts to return to a gold standard or to any of its analogies, independent of its form, would be regressive.

Nevertheless, the fact that the current USD cannot fully fulfill the function of a global currency is obvious.

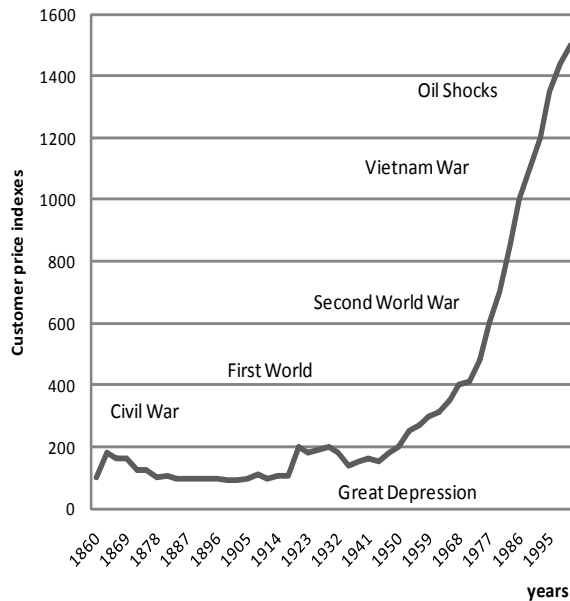


Figure 1. Customer Prices in the United States from 1860 to 2004 (1860 year = 100)

Source: U.S. Department of Labor, Bureau of Labor Statistics.

The attempts to implement an alternative global currency, the so called special drawing rights (SDR), have had no significant success due to the USA's unwillingness to lose their position as a global currency issuer.

The continuation of using the USD as a global currency has provided obvious essential advantages for the US. However, it contains less obvious and underlying risks: the quick increases in internal and external US debt, both state and private. The USA's growth has become a mostly "growth by debt" economy.

The floating rates of leading world currencies, first having appeared after the breakdown and demise of the Bretton Woods system, have gone on to create new problems for the global economy. That is not only the usage of the USA's currency as a world currency (which has no internal value) has created an increase in international trade risk. The exchange rates, unpredictability, have not contributed to such a development at all.

The Louvre Accord of 1987 has provided that the leading economic countries keep their currency exchange rates within their so called "recommended limits", e.g., 1.6–1.8 DM for 1 USD<sup>1</sup>.

However, the Louvre Accord did not fully follow the framework of the Bretton Woods Accord.

<sup>1</sup> P. Samuelson, W. Nordhaus: *Macroeconomics*, Publishing house "Osnovy", Kiev 1995.

The USD position became unstable due to the creation of the Euro (the latest competing global currency). However, the Euro, while having pressured the USD has not achieved a global currency status.

### **Results of Analysis**

After an analysis of the above information we can begin to draw certain conclusions.

Firstly, the current global economic crisis is not the consequence of accidental circumstances. It is the logical result of a developing world economy under globalization conditions without any efficient global currency system that corresponds to the development needs of the world.

Secondly, the lack of a global currency system can be explained because there is no current currency capable of being an effective global currency. The USD has long been used for such purposes.

Thirdly, there is no real alternative to the USD yet.

Therefore, there is a necessity to create a new global currency. What should it be like? Who and in what way should this currency be created by and implemented? The future global economic development will significantly depend on the solution to the above issues; and delaying a solution for these issues could complicate and worsen the situation making it even more difficult to solve in the future.

The creation of a future global currency depends on the goodwill and co-operation of the world economic leaders, such as the United States of America, the European Union, China and Japan.

The responsibility for the further development of the global economy has been put in the hands of a limited group of the economic leaders, who are responsible for the majority of global GDP. Here, the IMF could play a significant role as an immediate new currency issuer.

Such a currency exchange rate could be determined in terms of a basket of leading national regional currencies, such as the USD, Euro, Yuan, and Yen.

The gradual exchange of the trillions of USD circulating beyond its borders to the new currency could provide a relatively painless transition to a new global currency without economic shocks or collapses.

It would protect the world from the repatriation of huge sums of currency to the USA, which could ruin the country's monetary and credit system and its economy. Due to the USA's large economic standing, it would most likely negatively influence the global economy. No one wishes for a dollar currency crash, as well as an undesirable monetary reform within the US, which would also prove to be detrimental for the dollars circulating outside of the country.

## **Conclusions**

The creation and implementation of a global currency will provide multiple advantages:

1. The efficient international control through the IMF could determine currency issues (money production) according to the global economy's needs.
2. Establishment of a global currency rate based on a weighted basket made up of the leading national and regional currencies can provide a timely response to important global economic changes.
3. Use of this global currency by national economies can help stabilize global economic growth.
4. A new global currency can lead the way to further globalization. A nation's response to globalization shouldn't be as a counter reaction, but rather as a search of their own valued place within global markets and the efficient participation in the international division of labor.

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## **Summary**

This paper raises concerns about the most recent global currency situation and provides an idea for what future globalization will look like under a global currency.

The main contradiction in international currency relations has been a consequence of using the USD as the global currency soon after the gold standard was eliminated.

It is indicated that the origin of the global financial crisis was predictable and is the consequence of global economic development under the conditions of globalization without any efficient global currency system being in place to effectively tether the global economy.

The criteria and requirements for a new global currency as a necessary prerequisite of the efficient global currency system's functioning have been formulated.

It has been postulated that using this new global currency as a reserve currency by national economies could help the global economy in its efforts for future stabilized growth.